Testimony of
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I. Overview

Mr. Chairman and Members of the Subcommittee.

Thank you for the opportunity to appear here today. I am pleased to offer testimony on current issues affecting the outlook for the Nation's electric transmission system. In particular, my testimony will focus on the development of regional transmission organizations (RTOs) and how the Federal Energy Regulatory Commission (FERC or the Commission) can help on infrastructure improvements and investments. The views expressed in this testimony are my own, and do not necessarily reflect those of the Commission or any one Commissioner.

A competitive market is the best way to protect the public interest and ensure that consumers' needs are met over the long run at reasonable prices. For competition to flourish and bring benefits to wholesale as well as retail customers, it is critical that there be adequate transmission to carry electricity from sellers to buyers. It s also critical that transmission services be provided on the interstate grid on a fair and non-discriminatory basis.

The transmission grid is the essential superhighway for interstate electricity commerce, but it is becoming congested due to increased demands. The use of the interstate transmission grid has grown dramatically, but transmission expansion has not kept pace with these changes in the

interstate electricity marketplace. Also, wholesale electricity markets have become much more regional than local, encompassing large multi-state areas. Thus, the existing grid is being pushed to its operational limits, and transmission constraints frequently prevent the use of lowest cost generating facilities. The institutional structures used in the past for planning and expanding the grid are not currently meeting our needs.

For a number of years, the Commission has recognized the importance of an efficient transmission grid, and has exercised its authority to make the transmission system operate efficiently.

II. Order No. 888

The Commission addressed the issue of access to the transmission lines of public utilities in its Order No. 888, which was issued in 1996. There, we found that unduly discriminatory and anticompetitive practices existed in the electric industry, and that transmission-owning utilities had discriminated against others seeking transmission access. Accordingly, Order No. 888 required all public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to provide open access non-discriminatory transmission tariff service and to functionally unbundle wholesale power services from transmission services.

III. Order No. 2000

In Order No. 2000, issued in 1999, the Commission sought to address several remaining transmission impediments to competition in wholesale electricity markets. These impediments were identified as continuing opportunities for discriminatory treatment in access to transmission lines, and engineering and economic inefficiencies in the planning and operation of the transmission

system. We identified the following specific problem areas that Order No. 2000 is intended to address: the reliability of the nation's bulk power system is being stressed in ways that were not experienced before; it is increasingly difficult to accurately compute the available transmission capacity on transmission facilities; existing transmission congestion management systems do not optimize regional congestion relief and are cumbersome, inefficient and disruptive to bulk power markets; the uncertainty associated with transmission planning and expansion have resulted in a noticeable decline in planned transmission investments; and pancaked transmission rates (where a separate access charge is assessed every time the transaction contract path crosses the boundary of another transmission owner) restrict the size of regional power markets. Order No. 2000 also recognizes that wholesale trading patterns have become increasingly regional and multi-state in character.

Many of these transmission problems, we found, could best be addressed if the interstate transmission grid were operated on a regional basis, in a manner which is independent of entities that are buying or selling electricity. Utility-by-utility management of the interstate transmission grid is inadequate to support the efficient and reliable operation of the bulk power market. Accordingly, Order No. 2000 requires all public utility transmission owners and operators to submit filings related to the creation of regional transmission organizations (RTOs). RTOs are institutions that will own and/or operate the transmission grid on a regional basis and that will not participate in the power sales business, i.e., they must be independent of power market particpants.

Order No. 2000 requires that RTOs address essential transmission functions on a regional basis. These functions include operation of the grid, maintenance of reliability, congestion management, planning and expansion, calculation of transmission capacity, parallel path flow management, and tariff administration. Although not all transmission owners are public utilities subject to the Commission's general Federal Power Act jurisdiction, the goal of Order No. 2000 is for all transmission-owning entities, including non-public utility entities (e.g., municipal and electric power cooperative utilities) to place their transmission facilities under the control of independent RTOs.

Accordingly, in the future, the Commission will look to RTOs not only to ensure non-discriminatory access over the interstate grid, but also to manage congestion over existing regional transmission constraints and take the lead in regional transmission planning and expansion to remove or mitigate constraints over the long-term. RTOs must have the authority to ensure the short-term reliability of the regional grid and must be responsible for planning, and for directing or arranging, necessary transmission expansions and upgrades that will enable it to provide efficient and reliable transmission service. We expect that the RTOs will have a process for determining the most cost-effective transmission upgrades, and that this process would take into consideration any technological advances in the transmission of energy that may be available.

IV. Commission Efforts to Establish RTOs Expeditiously

Recognizing the critical importance of transmission issues, FERC established an aggressive timetable in Order No. 2000 for RTO implementation, and we have been acting expeditiously in response to the RTO filings. Since the beginning of 2001, the FERC has issued over 20 orders on

RTO filings. The Commission has also recently ordered mediation in an effort to create one large RTO for the Northeast U.S. and another for the Southeast U.S. Creation of effective RTOs has been and continues to be one of the top priorities of the Commission.

V. Other Commission Actions

In addition to efforts to get RTOs established, we have recognized that there must be adequate returns on transmission investments so as to encourage such investment by the private sector. Order No. 2000 specifically recognizes the importance of transmission pricing reform, and indicates the Commission's receptiveness to innovative rate proposals that would reward those making new transmission investments.

FERC also believes that so-called "merchant" transmission projects sponsored by entities other than traditional utilities can play a role in expanding competitive generation alternatives for customers, and it has taken initial action on two merchant high voltage direct current transmission line projects: the Neptune Regional Transmission System, LLC project consisting of several thousand miles of undersea cable which will connect capacity rich regions in Maine, New Brunswick and Nova Scotia with capacity constrained markets in Boston, New York City, Long Island and Connecticut; and the TransEnergie U.S. Ltd. 26-mile undersea cable project from Connecticut to Long Island, New York.

In evaluating these proposals, the Commission has established criteria to use to determine whether merchant transmission line projects should qualify for negotiated or bid transmission rates: the merchant project should assume full market risk; the merchant project should create tradable transmission rights; the merchant project should not preclude access to essential facilities by

competitors; the merchant project should be subject to market monitoring for market power abuse; the physical energy flows on the merchant project should be coordinated with, and subject to, reliability requirements of the relevant RTO; and the merchant project should not impair pre-existing property rights to use the transmission grids or inter-connected RTOs or utilities.

Another related area where we have acted to increase efficiencies involves interconnection of generating facilities with the transmission system. In recent orders the Commission has stated its intent to evaluate in the near future the importance of standardizing interconnection policies and procedures. FERC has already taken some steps in this direction by encouraging utilities to file their interconnection rules. Standardizing interconnection rules and procedures may help minimize cost and barriers to entry for new generation.

VI. Limitations on the Commission's Ability to Resolve Transmission Issues

FERC is statutorily unable to directly and completely address all transmission problems. A significant portion of the nation's transmission grid is owned and operated by utilities not subject to FERC's open access requirements. For example, the Commission has limited authority with respect to transmission facilities owned by the Federal government, state and municipal governments, and rural electric cooperatives or within the Electric Reliability Council of Texas (ERCOT). Public power entities control about 30% of the nation's electricity transmission grid. We have encouraged public power and cooperative entities, which constitute such an important part of the Nation's electric system, to participate fully in RTOs. In Order No. 2000, the Commission stated that a properly formed RTO should include all transmission owners in a region, including municipals, cooperatives, Federal power marketing agencies, Tennessee Valley Authority

and other state and local entities. Certain tax laws impede public power and cooperatively-owned utilities from fully participating in the development of RTOs. One such example is the Internal Revenue Code's restrictions that may prevent transfer of operational control of existing transmission facilities financed by tax-exempt bonds to a for-profit transmission company.

FERC also has no authority over transmission siting decisions. Even though public utilities must offer to expand transmission facilities to fulfill a transmission service request, the utilities first must obtain siting permission from relevant state and local authorities.

VII. Changes that Have Been Proposed to Improve Transmission Efficiency

Although the Commission itself has not taken a position on what action Congress should take with respect to transmission issues, and I a staff member do not here make any such recommendations, I note that a number of measures have been proposed to improve the operation of the Nation's transmission system. Among these are:

- proposals to extend the Commission's open access regulatory authority to all transmission facilities, including those owned by municipalities, rural cooperatives, the Tennessee Valley Authority, and Federal power marketing administrations;
- proposals for the Commission to have transmission siting authority for transmission facilities as a backstop in limited circumstances;
- proposals providing for enforcement of transmission reliability rules by a self-regulatory organization subject to the Federal oversight; and
- proposals for legislation to eliminate tax code and other restrictions that impede public power entities from fully participating in RTOs.

VIII. Conclusion

Full and fair access to efficient and reliable transmission service is vitally important to competitive electricity markets. The Commission has been diligent in exercising its authority to promote competitive markets. Currently, in our view, the creation of RTOs is the best approach to addressing a wide range of transmission problems, including transmission congestion and expansion of the transmission grid, among other things. RTO implementation is one of the Commission's top priorities.